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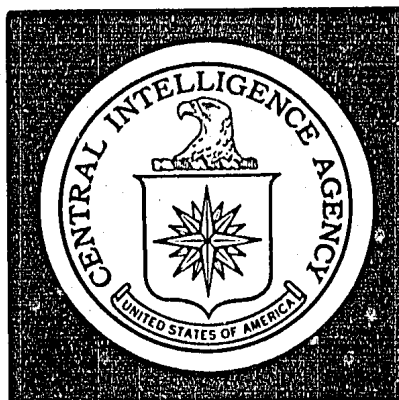

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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Some Recent Trends In The French Economy

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1970

INTELLIGENCE MEMORANDUM

Some Recent Trends In The French EconomyIntroduction

For more than a year after the May/June crisis in 1968, the French economy suffered one of the worst periods of currency speculation in its postwar history; massive capital outflows and foreign trade deficits threatened to deplete French official reserves. However, since the devaluation of the franc on 10 August 1969 and the accompanying stabilization program, French foreign trade has returned to normal and the balance of payments is now in surplus. The outlook for continuing improvement in the balance of payments and trade, resuming stable economic growth, and the government's program for modernizing the economy will depend heavily upon more effectively controlling domestic inflation. The government's deflationary policies have thus far failed to curb price increases significantly. This memorandum discusses the reasons for the recent improvement in France's foreign trade and the persistence of domestic inflation as they affect the economic outlook for the rest of 1970.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence and the Office of National Estimates.

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Background*

1. During the period June 1968 to August 1969, France exhibited the typical characteristics of an inflationary economy. The steep rise in wages required to restore labor peace in the wake of the spring riots and strikes triggered a sharp increase in domestic demand which was soon reflected in rising prices. At the same time the government deliberately followed inflationary policies that stimulated quick economic recovery. Nevertheless, the economic disturbances caused by the riots had shaken public confidence and had increased speculation on the eventual devaluation of the franc.

2. A massive outflow of capital began during the summer and continued into the fall of 1968, reaching a peak during the international monetary crisis in November. Speculation tapered off as this crisis subsided and the government added more controls. Price surveillance was intensified and stricter fiscal and monetary measures were adopted. Exchange controls were instrumental in curbing the outflow of capital through much of the first half of 1969, but both producers and consumers turned to speculative purchases as a hedge against further inflation, a franc devaluation, and/or a Deutschemark revaluation.

3. The political uncertainty following De Gaulle's resignation in April 1969 intensified the speculative process. As a result, the trade deficit, which had increased sharply in the last half of 1968, reached unmanageable proportions in the first half of 1969. The overall balance of payments deficits, which had climbed to \$2.4 billion for the last half of 1968,

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eased to \$1.7 billion for the first half of 1969. But, with the trade deficit mounting and confidence in the franc still shaky, a major financial crisis threatened the newly elected government. In the face of this threat, Pompidou devalued the franc in August 1969.

4. As a follow-up to the August devaluation Pompidou launched a comprehensive domestic stabilization program noted more for its bark than for its bite. The stated goals of the stabilization program were (1) to restore equilibrium in France's foreign trade and (2) to contain domestic inflation. The first goal clearly was considered the more important. In pursuing these objectives monetary policy has been cast in the leading role. Aside from extending credit controls to mid-1970, the principal innovations aimed at closing loopholes in existing controls and forcing banks to observe credit quotas imposed by monetary authorities. The Bank of France also raised its discount rate and reserve requirements. Consumer credit was tightened by raising downpayments and reducing repayment periods. In addition, a variety of savings incentive schemes and tax benefits (such as increased tax exemptions for bond interest and life insurance premiums) were implemented. The total package was impressive in the diversity of its components, but, in the effort to forestall renewed socio-economic discord, it was designed so that no individual or group (other than consumers in general) would be excessively hurt.

5. The devaluation itself has succeeded: on a payments basis, France's foreign trade is now in equilibrium, and capital, both foreign and domestic, has been returning. The stabilization program, however, has not as yet succeeded in fostering domestic economic stability; nor is a continuation of the present favorable trends in France's external financial accounts assured. While inflationary pressures are still strong, the government is under increasing pressure to relax economic restrictions, now that they appear to have accomplished their major stated goal: equilibrium in the balance of trade.

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CONFIDENTIALForeign Trade and the Balance of Payments

6. The 11.1% devaluation of the franc in August 1969, followed by the 9.3% revaluation of the Deutschemark in October 1969, has largely eliminated the speculative factors which were the major cause of France's huge trade deficit in the first nine months of 1969. A sharp deterioration in the trade account occurred following the spring 1968 crisis, and speculation on a franc devaluation soon became so strong that the whole structure of France's trade and payments was undermined.

7. Anticipating higher import prices following a devaluation, French importers built up inventories and sought to prepay their foreign purchases as much as possible. At the same time, foreign buyers of French goods attempted to postpone payment until after the devaluation. The resulting abnormal leads and lags were thus the major cause of France's foreign trade deficits before the devaluation. This is shown by the fact that payments for imports exceeded receipts for exports by \$0.5 billion in the second half of 1968 and by \$1.3 billion in the first half of 1969, while the trade deficit as recorded by French customs (adjusted to an f.o.b./f.o.b. basis) was only \$0.3 billion and \$0.5 billion, respectively, in the same periods.

Exports Boom Following Devaluation

8. In September 1969, exports, which had remained relatively stable through the first eight months of the year, responded to strong foreign demand (explained more by the tenacity of inflationary pressures in France's principal export markets than by any significant widening of the price advantage of French products due to the devaluation). At the same time, the level of imports has changed little. The major reversal has been in French-West German trade, in which France had run a chronic deficit averaging \$60 million monthly in 1969. The January 1970 French trade surplus with West Germany, totaling \$36 million, has been only the second monthly trade surplus with West Germany since April 1966.

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9. The index of French exports during the first quarter of 1970 was one-third higher than the corresponding quarter of 1969 (see Table 1). Such an exceptional rate of growth cannot be maintained throughout the year. Despite significant additions to productive capacity, domestic supply conditions are likely to become increasingly the major limiting factor. Export order books, already larger than normal, are still lengthening. But with many key industries already operating at near capacity levels, significant increases in output will become more and more difficult to achieve.

10. Restrictive government policies thus far have retarded the growth of domestic demand in order to channel a larger share of production into exports. If, under political pressure, these restrictions are relaxed prematurely, competition between domestic and foreign demand will intensify, raising prices and reducing the volume of goods available for export. Some easing of foreign demand, however, may be expected toward the end of the year in any case, as the deflationary policies followed by some of France's principal trading partners take effect. Accordingly, a slowdown in the rate of growth of French exports is likely in the course of the year. Nevertheless, an increase of 20%-25% above 1969 export levels appears reasonable.

Import Growth Checked

11. After the devaluation, the combination of (1) the reversal of speculative forces, (2) higher import prices, and (3) more stringent credit and exchange controls stemmed the growth of French imports. During the six-month period ending 31 March 1970, imports were only 4% above the level of the preceding six-month period. This stagnation of import demand reflects in part the impact of higher import prices largely because of devaluation and of restrictions on consumer credit. More important, however, it probably reflects a drawing down of inventories built up during 1968/69 in anticipation of the devaluation of the franc and revaluation of the Deutschemark. As these inventories are depleted, restocking will require an increase in imports.

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Table 1
French Foreign Trade Outside Franc Zone
Seasonally Adjusted

Period	Index (January 1969 = 100)		Exports as a Percent of Imports <u>a/</u>	Trade Balance (Million US \$)
	Exports (f.o.b.)	Imports (c.i.f.)		
1969				
January	100	100	88	- 132
February	98	98	87	- 133
March	94	97	85	- 156
April	105	111	83	- 202
May	103	113	80	- 248
June	108	114	83	- 212
July	106	119	78	- 284
August	108	115	82	- 220
September	115	125	81	- 252
October	123	129	83	- 234
November	119	114	92	- 99
December	126	120	92	- 102
Total				- 2,274
1970				
January	130	121	93	- 75
February	131	125	92	- 109
March	133	116	100	+ 1

a. The French authorities estimate that 7% of the total cost of imports arises from insurance and other transportation costs. Therefore, on a balance-of-payments basis, equilibrium is achieved when the value of exports (f.o.b.), expressed as a percentage of the value of imports (c.i.f.), equals 93%.

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- 7 -

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12. Past experience has shown that the average rate of growth for imports is twice that of industrial production. If this ratio were to hold for the current year, import volume would rise by 12% (compared with 3% projected for 1970 by the government). Even if a rough adjustment is made for the apparent draw-down in inventories, imports are not likely to grow at a rate less than the 6% expected for industrial production. With approximately one-fourth of French imports coming from West Germany, the revaluation of the Deutschemark has significantly increased the franc price of these imports. In the aggregate, it is estimated that French imports for 1970 will increase by 6%-9%, approaching \$16.0 billion (c.i.f.), up from \$14.6 billion (c.i.f.) in 1969. With exports likely to reach \$14.5 billion to \$15.5 billion, the foreign trade account would be in approximate equilibrium on an f.o.b./f.o.b. basis.

Balance of Payments Surplus in 1970

13. The reversal of leads and lags and the cooling of speculative fever following the devaluation of the franc and the revaluation of the Deutschemark generated a reflow of capital into the French economy. Approximately half of the \$5 billion which left France in 1968-69 has now returned. The Bank of France has used most of this inflow to pay off the \$1.5 billion in short-term debt owed to foreign central banks and half of the \$800 million owed to French commercial banks. At the same time, official reserves of gold and foreign exchange have risen from \$3.6 billion at the time of devaluation to \$4.0 billion. The outlook for a net inflow of long-term capital -- which is necessary if the government's program for modernizing the French economy is to succeed -- is promising. US and West German investors (which together account for more than one-third of foreign investment in France) plan substantial new investments in France in 1970. Barring unforeseen events, the equilibrium in trade on a payments basis, coupled with net inflows of long- and short-term capital, should produce a substantial surplus in the 1970 French balance of payments.

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Domestic Economic Outlook Uncertain

14. The improvement in France's foreign trade accounts has been the most spectacular and immediate feature of France's overall stabilization program; but the failure thus far to reduce domestic inflationary pressures to more tolerable levels has been the most significant indication that complete success has not as yet been achieved. There is some evidence, however, that tight monetary policies are beginning to produce results: the number of businessmen reporting financing difficulties is growing and consumer demand clearly is tapering off. Industrial production continues to increase at an annual rate of 6%, with strong foreign demand buoying up sluggish domestic demand, especially in the consumer goods sector, where the government's credit restrictions have been most effective. Real gross national product (GNP) for this full year will probably increase by 4%-5%, compared with about 8% last year.

Table 2

France: Indexes of Wages and Prices

December 1968 = 100		
Period	Index of Consumer Prices	Index of Hourly Wages and Salary Charges in Manufacturing
1969		
January	101.1	101
February	101.4	102
March	101.9	102
April	102.4	103
May	102.9	105
June	103.2	105
July	103.7	105
August	103.9	105
September	104.5	106
October	105.1	108
November	105.6	110
December	105.9	110
1970		
January	106.8	111
February	107.2	
March	107.6	

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Prices and Wages Continue to Climb

15. Inflationary pressures continue, primarily because costs are increasing. Producers, caught in a profit squeeze created by high interest rates and rising wages (see Table 2), cannot cut their selling prices. The rate of inflation may be somewhat less than the 6% posted in 1969, but is not likely to drop below 4% as the government predicts. The proliferation of cost-of-living clauses in wage contracts, while maintaining the purchasing power of France's workers, has also created the attendant problem of a wage-price inflation. Although all of the major labor unions appear determined to avoid strikes -- in part because of their recent successes in achieving most of their demands -- there is still significant, although as yet uncoordinated, unrest in local dissident labor groups and in nonunionized sectors of the labor force. Recent labor contracts indicate that wages are likely to continue increasing at an average annual rate above 10%. At the same time, a much slower rate of increase of labor productivity, due in part to labor unrest, will exacerbate cost pressures on management.

Conclusions

16. The stated purposes of the stabilization program were (1) to restore equilibrium in France's foreign trade and (2) to contain domestic inflation. The first and more important goal has now been achieved. Foreign trade is balanced, the balance of payments is in good shape, and the franc is strong.*

17. Domestic economic stability has not been restored. The rise in prices and wages in 1970 is now estimated to be only slightly less than in 1969. Prices will probably rise about 5% and wages at least 10%. GNP in constant prices will probably increase 4%-5% and industrial production at least 6%.

* *In recent weeks the franc has been exchanged at a rate above its official par value.*

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18. While political agitation for a relaxation of government controls is likely to increase, abandonment of selected parts of the stabilization program would intensify inflationary pressures and reverse the favorable trends in foreign trade. It would also inevitably delay the government's program to modernize the French economy, which in the long run offers the best hope for curbing inflation and ensuring domestic economic stability.

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